Snap One Holdings Corp.(Q4 2023 Earnings)

March 07, 2024

Corporate Speakers:

- Hayley Pierce; Snap One Holdings Corp.; Senior Vice President of Finance
- John Heyman; Snap One Holdings Corp.; Chief Executive Officer
- Michael Carlet; Snap One Holdings Corp.; Chief Financial Officer

Participants:

- Erik Woodring; Morgan Stanley; Analyst
- Cory Carpenter; JP Morgan; Analyst
- Stephen Volkmann; Jefferies; Analyst
- Robert Jamieson; UBS; Analyst
- Adam Tindle; Raymond James; Analyst

PRESENTATION

Operator^ Good afternoon. Welcome to Snap One Holdings Corporation's Fiscal Fourth Quarter and Full Year 2023 Earnings Conference Call. (Operator Instructions) I would now like to turn the call over to Snap One's Senior Vice President of Finance, Haley Pierce. Haley, please proceed.

Hayley Pierce^ Thank you. Good afternoon. And welcome to Snap One's Fiscal fourth quarter and full year 2023 earnings conference call. As a reminder this call is being recorded. Joining us today from Snap One are John Heyman, CEO; and Mike Carlet, CFO.

Before we begin, we would like to remind everyone that our prepared remarks contain forward-looking statements, and management may make additional forward-looking statements in response to your questions, including but not limited to statements of expectations, future events or future financial performance.

These statements do not guarantee future performance, and therefore, undue reliance should not be placed upon them. Although we believe these expectations are reasonable, we undertake no obligation to revise any statements to reflect changes that occur after this call. Actual events or results could differ materially.

These statements are based on current expectations of the company's management and involve inherent risks and uncertainties, including those identified in the risk factors section of our latest annual report on Form 10-K filed with the SEC.

All non-GAAP financial measures referenced in today's call are reconciled in our earnings press release to the most directly comparable GAAP measure. This call also contains time-sensitive information that is accurate only as of the time and date of this broadcast, March 7, 2024.

Finally, I would like to remind everyone that this conference call is being webcast and a recording will be made available for replay on our Investor Relations website at investors.snapone.com.

In addition to the webcast, we've posted a supplemental earnings presentation accompanying these results, which can also be found on our Investor Relations website. I will now turn the call over to our CEO, John Heyman. John?

John Heyman^ Thank you, Haley. And welcome, everyone. And I appreciate you joining us this afternoon. To begin today's discussion, I'll give some company background, followed by a review of our performance for the quarter and the year, and then I'll turn the call over to Mike Carlet, our CFO. He will discuss our financial results in more depth and provide an outlook for 2024. After that, I'll share some closing remarks before we open the call for questions. Let's get started.

As a reminder, at Snap One, we develop and distribute smart living platforms that empower professional integrators to deliver joy, connectivity and security to discerning residential and commercial customers worldwide.

We work with our network of approximately 20,000 professional do-it-for-me integrators to distribute our proprietary and third-party products through our ecommerce portal and local branches. We further support our integrator partners with our proprietary software platforms, service offerings and workflow solutions to allow them to successfully serve their customers throughout the project lifecycle.

We believe the smart living opportunity is large and it is durable and that long term secular tailwinds including technology adoption, software enablement, housing construction and small business formation will continue to propel the industry and our company forward. Many end users will seek professional help to select, install, integrate and support the technology solutions they require. Here at Snap One, we aim to provide our integrator partners with the right tools to capitalize on this opportunity.

While we have strong conviction in the United States housing market over the mid to long term, we are operating in a tough housing environment. Nonetheless, our strong fourth quarter and full year results highlight the resiliency of our business model and scrappiness of our integration partners.

Our team delivered year-over-year profitability growth despite top line headwinds including global macroeconomic uncertainty, channel inventory destocking and inflation. Our focus on extracting supply chain costs to increase contribution margin as well as our operating expense discipline enabled us to generate 2023 adjusted EBITDA of $117.2 million. Importantly, this reflects an expanded operating margin of 11%, a 90 basis point year-over-year improvement.

We are positioning ourselves for a turnaround in housing and are ready to build on our profitability momentum as we drive further operating leverage with expanded scale.

As we reflect on the operational highlights of 2023, there's no better recognition than the vote of confidence we receive from professional integrators. We were humbled by numerous industry awards, including: number 1, 45 top five brand rankings across 62 product subcategories in the 2023 CE Pro 100 brand analysis awards, representing approximately 5x the number of recognition of the next closest competitor included within the analysis; number 2, 14 2023 CE Pro, Quest for Quality Service awards across the 22 categories included in CEO -- CE Pro survey of professional integrators; number 3, best new hardware for Residential Tech Today Innovation and CEDIA Hall of Fame awards at the 2023 CEDIA Expo; and fourth and finally, two ISE 2024 top new technology awards.

We don't take these awards lightly. We recognize that to sustain and enhance our competitive position, we must continue to listen to our integration partners, develop innovative products, invest in our software platforms, and enhance end customer satisfaction with the smart living experience.

In January of this year, we officially announced the launch of Control4 Connect and a Control4 Assist.

As a reminder Control4 Assist is an optional service program for integrators to offer support to their customers, while Control4 Connect will be a mandatory software subscription on all domestic installs starting in late-April. Since acquiring Control4 in August of 2019, a major focus for us has been on improving our software and support offerings for both our partners and the end customer. After years of extensive development, market testing and integrator feedback, we have built a new software and support portfolio that we believe will transform this industry.

Control4 Connect and Control4 Assist were designed to enhance the end customer experience, build recurring revenues and incremental profitability for our partners and for Snap One, and ultimately align the industry in a way that benefits and delights the end customer and improve the system they acquire over time through valuable software updates and amazing service. These two services establish us and our integration partners as the clear leaders in an industry that must evolve to manage increasingly complex technology and more demanding customer expectations.

So far, the overall post-launch reception has been positive. We are seeing customers come online now and we are excited for our partners and end customers to benefit from the value of these offerings in 2024 and beyond.

Over the course of 2023, we outlined two key strategic initiatives: first, driving higher platform and product adoption by our partners, and in turn delivering far better end consumer experiences; and second, expanding our operating margins through several key programs, which have already yielded positive results.

From a platform adoption perspective, our continued innovation in our products, solutions and service models enhances our relationships with our partners, delivers a better end customer experience and drives market share gains for Snap One. With this in mind, we launched a large number of innovative new products throughout the year across many of our categories, with new launches planned for 2024.

Complementing our product portfolio, we continue to optimize our go to market strategy to drive ecosystem adoption, and we are pleased with all that we've accomplished this year as part of this initiative, including leveraging our best-in-class loyalty platform to drive product category and ecosystem adoption, and strengthen our relationships with partners. We're also converging our Snap One and Control4 portals in the United States, further enhancing our omnichannel initiative; and finally bringing together a unified experience for our partners.

And finally, we're expanding our strategic omnichannel presence by opening four net new local branches in 2023, including two in the fourth quarter. This brings the total number of North American branches to 45 as of year end. And continuing with this momentum, we have another branch slated to open in the coming weeks.

We intend to continue opening more locations in 2024 to serve our partners and their communities, though we plan to briefly pause additional openings during the first half of this year as we wrap up our efforts to migrate our branches to a single operating system.

While we continue to try to drive growth in our business, our second strategic initiative is achieving operating margin expansion. Through COVID and the recent supply chain challenges, we prioritized keeping our partners in business.

This created near term inefficiencies for Snap One. The supply chain is now largely normalized and our team has successfully extracted those cost inefficiencies, driving sustained contribution margin expansion this year.

We're also driving scale within our operating model. Integration activity related to previously completed acquisitions, as well as investments within our technology infrastructure have continued to yield results. These investments will support our operating leverage and growth expectations, going forward, and are evident in this year's results.

Let me now comment briefly on our outlook and then I'll turn the call over to Mike. While we hold a high level of conviction around our growth algorithm, we also think it's prudent to maintain a pragmatic view of the current operating environment.

Several of the factors that have applied modest pressure on our demand over the last few quarters all remain in the short term. However, as we projected last quarter, we now believe that the industry is arriving at its new normal level of inventory that we estimate. Additionally, while spending has declined a bit, our integration partners continue to report relatively healthy backlogs and remain optimistic about the future.

They are highly adaptable and have a proven ability to pivot to a variety of projects to remain successful in changing market conditions. These can include upgrading their install base with new products or pursuing commercial projects. We have a unique ability to support this flexibility with our diversified business model and product portfolio, which allows us to serve integration partners across a wide variety of price points and end markets.

While we're seeing some softness from more budget conscious end customers for entry-level projects, we believe that high-end residential housing remains resilient and our commercial pipeline is growing.

We expect some demand headwinds to continue into 2024, but we're confident that we're winning share and will emerge as an even stronger company as the operating environment bounces back. As we look to the rest of 2024, we expect the operating environment to remain uncertain, but we plan to achieve growth nonetheless. Accordingly, we have constructed a strategy to not only drive expansion in 2024, but to position Snap One to transform the industry and win market share in the years to come.

To achieve this, we're executing on several strategies, including: we're expanding our share of wallet with existing integrators, through the further adoption of our ecosystems and product categories, the introduction of innovative new products and the expansion of our local branch footprint; we're elevating the end consumer experience by offering cutting edge support services such as Control4 Connect and Control4 Assist that will align the industry in a way that benefits the end consumer and ultimately increases the demand for our products; we're growing beyond our core business, especially in commercial markets, as we work to drive outsized growth by introducing new products and solutions in the near term; we're driving operational efficiency and scale by expanding our profitability, continuing to optimize our inventory position and investing in our infrastructure; and finally, we're bolstering our own foundation by maintaining a strong employee engagement with the best team in the industry and making it easy for our integrators to buy from us week-after-week through whatever channel they prefer.

With that, I'll turn the call over to Mike Carlet, our CFO, to discuss the fourth quarter and full year results and 2024 outlook in greater detail. Mike?

Michael Carlet^ Thanks, John. I'll start with talking about our financial results for the fourth quarter and the full year ended December 29, 2023. Net sales in the fiscal fourth quarter decreased 1.4% to $264.4 million, down from $268.2 million in the comparable year ago period. For the full year ended December 29, 2023, net sales decreased 5.6% to $1.06 billion from $1.12 billion in the year ago period.

As John alluded to earlier, our data shows that integrator has been working through their elevated inventory since their levels peaked around mid-2022, and our data now indicates that our partners inventory levels largely flattened in Q4. Even though channel inventory remains slightly elevated from the pre-2022 levels, our data suggests we have reached a new normal and while destocking did serve as a notable headwind to sales in 2023, do not expect to see major stocking or destocking activity going forward.

Our selling, general and administrative expenses in our fiscal fourth quarter increased 6.2% to $88.2 million or 33.4% of net sales from $83 million or 31% of net sales in the comparable year ago period.

The increase in SG&A expenses was primarily attributable to our long-term strategic growth investments, costs associated with local branch openings in the past year and a change in fair value adjustment to contingent consideration. This was partially offset by a decrease in acquisition and integration-related costs.

For the full year 2023, SG&A expenses increased 1.6% to $359.8 million or 33.9% of net sales, up from $354.3 million or 31.5% of net sales in the comparable year ago period. The increase in SG&A expenses was attributable in part to a change in fair value adjustments to contingent value rights and the costs associated with opening local branches in the past year; again, partially offset by a decrease in provisions for credit losses on notes receivable. Our net loss of $5.8 million in the fourth quarter compared to a net loss of $4.1 million in the comparable year ago period. And for the full year, our net loss totaled $21.4 million compared to a net loss of $8.7 million in the comparable year ago period.

Contribution margin, a non-GAAP measurement of operating performance, increased 4.3% to $110.3 million or 41.7% of net sales in the fiscal fourth quarter, up from $105.8 million or 39.4% of net sales in the comparable year ago period.

Contribution margin as a percentage of net sales increased largely due to continued momentum from our supply chain cost management initiatives driven by our teams as well as a modest impact from cumulative price adjustments we took in the last 12 months. This was partially offset by a lower proprietary product mix, which was largely driven by new local branch openings and incremental brand assortment of third-party products.

For the full year 2023, contribution margin increased 1.4% to $447.3 million or 42.2% of net sales from $441.2 million or 39.3% of net sales in the comparable year ago period. Contribution margin as a percentage of net sales increased largely due to the cumulative impact of price adjustments taken in the last 12 months as well as the execution of the supply chain cost management initiatives, which drove input cost efficiencies. Again, this was partially offset by lower proprietary product mix. For the full year 2023, third-party product sales represented 34.1% of net sales compared to 32.2% in the comparable year ago period.

Adjusted EBITDA, a non-GAAP measurement of operating performance, increased 10.7% to $29.8 million or 11.3% of net sales in the fourth quarter compared to $26.9 million or 10% of net sales in the comparable year ago period.

And adjusted EBITDA for the full year in 2023 increased 2.7% to $117.2 million or 11% of net sales compared to $114.1 million or 10.2% of net sales in the comparable year ago period. These increases were primarily attributable to the strong contribution margin rate expansion, partially offset by the net sales decline and the increase in SG&A expenses.

Adjusted net income, a non-GAAP measurement of operating performance, increased to $11.2 million or 4.3% of net sales in the fourth quarter from $10.5 million or 3.9% of net sales in the comparable year ago period. Adjusted net income, a non-GAAP measurement of operating performance, decreased to $40.3 million or 3.8% of net sales in the full year 2023 from $52.6 million or 4.7% of net sales in the year ago period.

Free cash flow, a non-GAAP measurement of operating performance, totaled $66.5 million in the full year ended December 29, 2023, compared to a negative $44.6 million in the comparable year ago period. This year-over-year significant increase in free cash flow was primarily attributable to the progress we made towards reducing our inventory levels.

We ended the year with $268.8 million in inventory, which overachieved against our stated inventory goal of $275 million. This contributed to our ability to fully pay down our revolver and build $156 million in total liquidity at the end of 2023, including cash and cash equivalents of $61 million and undrawn revolver capacity of $95 million.

As a reminder, a portion of this excess liquidity will be utilized in Q1 for annual payments related to the TRA, the employee incentive plan and for the general seasonality of the business. But overall, we are pleased with the current liquidity position of the company and the operational flexibility that it provides.

As mentioned last quarter, in the context of our capital allocation policy, our Board extended the current share repurchase program by one year to December 31, 2024.

As a reminder the Board previously authorized up to $25 million of share repurchases, of which the company has executed approximately $3.1 million to-date. With this extension, we will continue to evaluate share repurchases in line with our capital allocation strategy.

In addition to the financial metrics that we've reported to-date, we have a few key performance indicators that are intended to provide enhanced visibility into key operating metrics. These KPIs are related to the count of transacting domestic integrators and the spend curve transacting domestic integrator.

We will continue to present these metrics annually on a fiscal year basis. In fiscal year 2023, we transacted with approximately 19,700 domestic integrators, who, on average, spent $45,900. On a year-over-year basis, the number of transaction domestic integrators increased by 0.5%, while spend per transacting integrator decreased 4.4% as integrators destock their inventory position.

Finally, before I turn the call back over to John, I'll take just a few minutes to provide our financial outlook for fiscal '24.

As a reminder Snap One provides annual guidance for net sales as well as adjusted EBITDA as we believe these metrics to be key indicators for the overall performance of our business. Our '24 guidance considers our full 2023 performance and our conviction in the multifaceted growth strategy we have built while also confronting the continued market uncertainty that we believe will persist for much of 2024.

We expect net sales in the fiscal year ending December 27, 2024 to range between $1.06 billion and $1.13 billion, which will represent a range of flat year-over-year performance to an increase of 6.5% on an as-reported basis.

We believe the primary factors contributing to this '24 sales change to be: a, excluding the impacts of channel inventory, we expect net sales to range from a decrease of 0.5% to an increase of 2%. This performance reflects a market-driven change in sales volume, partially offset by growth from continued ramp up of local branches over the past year as well as very modest pricing actions; and b, we expect a 4% to 5% tailwind from channel inventory as we lap the channel destocking that occurred over the previous year.

We expect adjusted EBITDA in 2024 to range between $120 million and $128 million, representing an increase of 2.4% to 9.2% compared to the prior fiscal year on an as-reported basis. Our adjusted EBITDA guidance reflects our ongoing commitment to drive additional adjusted EBITDA margin expansion. We expect to achieve this both through continued contribution margin momentum stemming from our supply chain efficiencies as well as continued disciplined operating expense management.

Finally, as we think about our 2024 seasonal trends, when we look at the external demand factors, prevailing data continues to indicate slow activity across the housing industry. And it appears that this dynamic will likely continue at least through the first half of 2024, with some reports indicating a return to growth in the second half of the year.

Based on this settlement -- sentiment, as well as some of our own internal information, we would expect to see sales trending more strongly in the back half of the year. And as previously mentioned, we believe our integrator customers have reached a new steady state level of inventory, do not expect changes in inventory carried by our customers to have a material impact on our 2024 results.

But as our 2023 results include the headwinds of destocking activity, this serves as a source of year-over-year growth in 2024. More specifically, we believe the bulk of the selldown occurred in the middle of '23, with the majority of this benefit to be seen in second quarter and third quarter 2024. That completes my summary. I'll now turn the call back over to John for a few more comments. John?

John Heyman^ Thanks, Mike. A few closing thoughts before we hit Q&A. First, we are really proud of our team's ability to grow adjusted EBITDA compared to last year and expand our operating margins despite the headwinds the industry faced, and we remain confident in our expectations for consistent long term growth. This year, we made strong gains in our contribution margin as costs related to the supply chain alleviated, and additionally we executed on our operating margin expansion plan and we intend to make more progress in the coming year.

Second, we remain committed to our overarching strategy. This includes growth via new proprietary product launches, market leading service, expansion in our growth markets such as commercial and additional local branch offerings -- openings, excuse me.

As I mentioned previously, we're also very excited about our transformational software investments as seen through our Control4 Connect and Control4 Assist offerings. Even in an uncertain operating environment, we continue to strive to be the one partner that our integrators trust to support and grow their businesses.

And third, and finally, as I've said before, we believe that all homes and businesses will become smarter over the next decade, driving for demand for the types of experiences we offer today and those we can only imagine in the future. We've invested in scale and platforms that will drive better solutions for the end customer, more capacity for the integrator, and growth for Snap One in a way that increases operating margins over time.

We remain highly confident in our operating model and believe that our resilient integration partners, our diversified business model and consistently strong execution position us to prosper in a dynamic macro environment. At Snap One, we believe that our time is now and we are excited to implement our vision for 2024 and beyond. And with that, Norma please open the call for Q&A.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) Our first question comes from the line of Erik Woodring with Morgan Stanley.

Erik Woodring^ I just have two. Maybe just on the -- maybe the first one is just kind of high level. We went through how you were -- how many integrators and spend for Integrator trended in 2023. Can you just give us a bit of detail on how you expect that to trend in 2024? And how do you expect that to compare to the broader industry, meaning how much share do you expect to gain or lose? And why that might be? And then I have a follow-up, please.

Michael Carlet^ Sure, Erik. I'll jump on that. How are you doing? I think as we think about our guidance for this year and the components of it, we would expect our integrator count in 2024 to be relatively consistent with 2023. Our focus is we go into 2024 is on the launch of Control4 Connect and Assist.

As John talked about, it's on the platform adoption activities that we have. We obviously are continuing to add integrators all the time, but obviously some folks go out of business every year there's some turnaround that generally when people start buying from us, we retain them for the life of their business. But right now, we would expect the majority of our growth to come more from share of wallet activities and the platform adoption activities that we're driving.

So if we really think about our guidance for next year, there's really three components of it. There's what's the market going to do? What is the platform adoption share of wallet we're going to do, and what's the channel inventory impacts?

Channel inventory is 4% to 5%. Again, as we think about what happened last year, that's a pretty noble number to us. We're guessing what the market is going to do. And right now the market looks like it's a bit challenging. And so we're predicting the market to be for the year.

Anywhere from flattish to down. 5% is our best guess. But the further out you go, the more we're guessing at that as we think about the end of the year and trying to predict the housing market and the remodel market.

And then we think we have confidence in our opportunity to grow share of wallet and market share. The data that we get from talking to industry buying groups, from interacting with our customers, from thinking about [pull-through] information and how we show up on that, continues to indicate that we are growing share. And so, we continue to expect to see that happen.

However, we're not talking about significant share gains that's a couple points of growth which drives the spread of performance that we're forecasting for next year.

John Heyman^ Mike, let me just add to that before Erik asks his follow-up question. Erik, we came out of a period of time where we were significantly constrained on certain products from an inventory standpoint, as you know. And I think that at the same time, we were delivering a lot of product innovation, especially during 2024 or 2023 as componentry eased up.

And one of the things we are very focused on now is we have 20,000 integration partners, but there is a segment of them who are fully adopted in our ecosystems and understand how that drives more profitability for them and a better experience for the end customer. And so, to the number of integrators we're looking to add this year, we're certainly continuing to add integrators. But I would say our focus has shifted to; with the products we now have, and the inventory availability easing up, to driving share of wallet.

And we're doing that in a number of ways and we're starting to see some success. So that will be something we continue to talk about this year with you all. Thank you and take your follow-up.

Erik Woodring^ No. No. Very fair. I guess a second question was just on some of the drivers of your contribution margin. Obviously this year, some really nice improvements that you made on supply chain cost management initiatives. Obviously, pricing actions had a pretty significant on contribution margins in 2023.

Can you just help us understand some of those factors and how they relate to contribution margins in 2024? Just so we can kind of understand the shape of the curve between operating leverage and contribution margin expansion as you get to that EBITDA guidance that you provided for us. And that's it for me.

John Heyman^ Mike?

Michael Carlet^ Thanks, Erik. Yes. We don't guide to the contribution number, specifically. If you think about last year, pricing was an overall 3% growth last year, year-over-year. We actually have done very little pricing in '23. Most of the pricing impacts in '23 were actually carry over from late '22 pricing actions, and we expect minimal pricing action in '24.

We announced about a 1% blended price change at some SKUs that went up, some SKUs that went down, but overall [went into] 1%, which went into effect in January. And as of now, we're not thinking about additional pricing action this year. We'll always be thinking about it based on market conditions that are out there.

So pricing is a small component of it. Really, having said all that, we do expect contribution margin to continue to grow. Our team has been doing lots of work from a sourcing standpoint with our suppliers, driving cost down, driving efficiency across the supply chain. And we do expect to see continued contribution margin expansion as we go forward.

Operator^ Our next question comes from the line of Cory Carpenter with JP Morgan.

Cory Carpenter^ I wanted to ask on the recent software product launches, hoping you could expand a bit on the early reception you're seeing, and then maybe more specifically what you're building into the guide around adoption and monetization as we progress through the year?

John Heyman^ Well, we kicked off the launch, Cory, with summit, where we invited some of our top Control4 customers, when I say some, hundreds, and we spent two to three days with them. This of course was after a pilot period, beta, if you will, with tens of them. And it's also on top of the experience we've had with hundreds of Parasol partners and over 100,000 4Sight subscribers. And I think the announcement was quite notable in the industry. I think, it met with great press coverage, maybe with the exception of one columnist.

And inside our summit, the response was fantastic. I couldn't literally not have been more pleased, and I'm an optimist. And when we did a survey afterwards, the sentiment on those who attended the reception was staggering.

And while we had a -- the subscription offering for the software was mandatory, the Assist, the support offering where dealers may or may not pride themselves on the level of service they provide the end customer. It was amazing to me, like people really see that as a way to provide their end customer with more service and they can't do it themselves. They just don't have the manpower to staff seven days a week, 24 hours a day. And so, we were quite pleased with that.

The sales sentiment. So we had the top couple of hundred Control4 partners, but there's over 3000 Control4 partners who weren't at the event. The sentiment from our sales force post event has been exceptionally strong. There's always nitpickers out there in terms of social media and so forth, but we continue to educate them. And what's been really interesting is watching other dealers educate the nitpickers, if you will.

So we have strong conviction. We're starting to see it in the numbers, by the way, like -- to even though it's not required today, it's not required till the end of April, we're giving the market some time to absorb this and teach their salespeople about it, et cetera.

Literally the first week after the summit, we started seeing subscribers come online. The pace of the subscribers coming online is increasing. It won't really turn upwards in my mind until it becomes mandatory. What we have done in terms of our own guidance to the Street is we've been conservative.

We are only launching this inside the U.S. It's not being launched outside the U.S. right now. We are inside our models. We are assuming that with the launch we'll have around -- these are round numbers, 15,000 to 20,000 subscribers for our Connect offering by the end of the year, so that will start to really ramp in May. We'll be able to talk to you more about that after the second quarter.

We're modeling the Assist and Assist Premium. Those are the two levels of support, to have a much lower attach rate for them, less than 10% of the subscribers. I think, I'm expecting to see some upside there. By early next year -- so that's how this will ramp this year. So kind of our exit run rate.

We're anticipating to be in the high-teens to 20,000 subscribers. That translates, by the way, when you add it all up to recognized revenue because there's a difference between booked revenue versus recognized revenue because they don't start paying until their system is installed.

And so, this year we expect to have a fairly small amount of recognized revenue, roughly $2 million. But that increases quite significantly next year into the tens of millions as the install base grows. And we make this available outside the United States. So to sum it all up, I would say high-teens to about 20,000 subscribers this year.

Think about that growing 50,000 plus subscribers a year. The mandatory offering of $250 a year should be applied to those numbers. The integrators share a percentage of that, roughly 40% of the Connect fee and 30% of the Assist fees. Since we do work, more work, with -- we man the phones there. Those offerings cost $900.

The service offerings are either $900 or $3000, depending on which service offering you elect. Those are all well tested price points in the market at this point now. And so that's how we build the model. And so if you'll let me for a second, none of those numbers sound big when I start with $2 million this year.

By the way, we do about $13 million right now with 4Sight and Parasol. So that would be $15 million total.

But if you let yourself think out five years and you think about the history of our install base, and you apply very like less than 10% penetration of our service offerings Assist, and you multiply every single one of our installs by $250 for Connect.

Then you end up with somewhere around 270,000 subscribers in five years, and that drives roughly $95 million of revenue. When you apply our mix, that's all highly profitable recurring revenue. And that does not include us creating an offering for the 500,000 or so install base of existing Control4 customers that we would want to put on top of that 270,000. This is why we've invested well over $10 million over the past couple of years building this.

This is why we've been spending time with the 4Sight subscription product, the Parasol service product. We think it can transform the P&L of our company. But we also think it can transform the P&L of every integrator out there who is trying to develop recurring revenues. I'll stop there.

Cory Carpenter^ That was super comprehensive. I appreciate it.

Operator^ Our next question comes from the line of Stephen Volkmann with Jefferies.

Stephen Volkmann^ John, that was very comprehensive. And you mentioned strong margins on these recurring revenues. Is it reasonable to think of those as just kind of normal SaaS-type margins, like 80% or something? Or would there be some other cost in there we should just keep in mind?

John Heyman^ I think there's two different offerings. There's the Connect offering. And the way I would think about that model is -- of a dollar of revenue, we share 40% with the integrator. So 60% goes to the bottom line. There's some costs against that, call it 5% other variable costs. And so think of that as kind of a mid-50s margin project -- product, excuse me. And then with the Assist offerings, think of them similarly.

But we have a smaller share for the integrator. They only get 30%. We get 70%. But we're still at mid-50s gross margins because we have to do some work there in terms of cost of sales, specifically labor. And so that's how you should think about it.

Stephen Volkmann^ And then maybe a little more granularly, Mike, your waterfall relative to contribution margin in the quarter, the 2.7% from various cost goodness. I guess. How should we think about that, going forward? Is that sort of a catch-up and we're kind of done? Is there more you can do in that particular bucket of costs that we can expect going forward?

Michael Carlet^ Yes. Thanks, Steve. If we're not done by any stretch. I don't think we expect it to grow that much going forward. I think as you think about '23 versus '22, a lot of the waste that everybody was doing, the system is sort of self corrected, whether that's Ocean transportation, some other things that were out there.

So part of that 2.7%, I think, is just something that everybody's experienced as things have normalized. Not to take credit away from all the supply chain teams everywhere that have worked really hard to make that happen.

As we go forward, we continue to have a focus on driving additional incremental opportunities across the supply chain. And so we would say that, we would expect 50 basis points type of improvement from additional cost activity as we go forward next year. That's a relatively conservative internal number that we have. Our internal goals are higher than that.

But I think as you think about our guidance -- that's what we think is still out there from the efforts that we're putting forth, that we can generate with hopefully upside from there. But that's real activity from our teams. That's not market activity or correction. That's really things that our teams are doing to drive effectiveness and efficiency in the supply chain.

John Heyman^ Our supply chain teams and our engineering teams, now that all these componentry issues are out of the way, are getting back to what they were doing before. COVID and supply chain, which was figuring out how to take cost out of the products for the industry. Some of that will retain in terms of margin, some of that will pass on to the industry in terms of price. But the amount of replatforming that the company has done engineering, working with supply chain and our purchasing operations, I think we'll continue to see benefit out of that. And I just want to call those efforts out of those teams.

Stephen Volkmann^ And then just a final quick one, 1P/3P mix, any visibility into that going forward?

Michael Carlet^ I think we expect two things to happen. While on a like-for-like basis, we would expect the continue to see the 3P mix continue to be a slightly higher percentage of sales. It's going to grow 50 to 100 basis points more for the next couple of years. That's mostly driven by our local store openings, the mix at local, as we add TVs at local stores, we'll continue to drive that mix down.

Right now, I think for the year we ended at about 66%. I know, I quoted it earlier, I just don't have it right in front of me.

But it's about 66% proprietary product, which was, I think, compared to close to 68% the year before. And I'd expect that to continue to slip down a little bit, offsetting that as this RMR revenue grows, not this year, as John said, the impact of Control4 Connect and Assist is pretty minor this year, but going forward, as we think, about '25 and beyond, that should offset that.

So after this year, our models say that the 1P/3P mix should hold relatively flat with the incremental RMR offsetting, whatever happens from local store openings and the introduction of 3P products on a sort of steady state basis. We might always do things in the future that would change that, but at least as we think about the current model, that's what we would expect in the future.

Operator^ Our next question comes from the line of Robert Jamieson with UBS.

Robert Jamieson^ Congrats on the numbers today. Nice margin performance. One thing I -- how should we think about the physical store locations? I know you're pausing new openings, but you talked about transferring all these stores to a single operating system. I'm just curious what you think, is there margin benefits that we should expect there?

Michael Carlet^ There are some small operating margin benefits. If you think about what we've had to do over the last four years is we've been really operating almost six different platforms in the company. The old Snap AV platform, this old Control4 platform, and a platform for each one of the four legacy local businesses that we bought back in 2018 and '19.

And I can tell everybody we're two years into our 5-year plan that existed pre-COVID, and the whole COVID disruption and supply chain disruption caused us to go very consciously a lot slower on those things as we focused on the supply chain and maintaining inventory for our suppliers and all the other things that lots of folks in the world have had to do.

As we bring all those systems together, we've combined Control4 and Snap in the U.S. into a single portal instance.

We're in the process. We have about half of our local stores as of this week operating on our new platform. There's more conversions coming. We expect to have that done sometime around the middle of the year with all the stores. That obviously provides effectiveness and efficiency.

Where you don't have four different platforms that you're operating on, it's not a huge amount, maybe $1 million or $2 million on the bottom line by that effectiveness. But we do think going forward in the future, some of the soft benefits of having one system that to maintain being able to be more consistent with our marketing messages is all out there.

And even in the future, we have more work to do. We have different international systems we have to continue to consolidate. There's some other things that we have to continue to think about from a platform standpoint, but this really gets a lot of the effectiveness of Snap and Control4 coming together and the local stores coming together.

Robert Jamieson^ That's great. Very helpful. And then just a quick one on seasonality. I know you said embedded in the guidance to expect second half to be stronger. Should we think about that more like, if I'm looking back in history, like 45% in the first half, 55% in the second half, is that kind of like fair to think about?

Michael Carlet^ Yes. I think directionally I don't have the quarters in front of me, but I think the issue really is this market activity. I think what we're saying is right now the market continues to be a bit weak and we're continuing to capture share and there's no expectation in the next 2, three months the market is going to see a dramatic turnaround. But I think there is optimism on the back half of the year. So there always is some seasonality in the business, which I think is usually again, 46%-47%, 45-46% of EBITDA as we go.

There's impacts of local store openings as you go through the year and the timing of them that impacted as well. But I think this year it's going to be even a little bit more dramatic just given the overall market activity that we're anticipating.

Operator^ Our next question comes from the line of Adam Tindle with Raymond James.

Adam Tindle^ John, I wanted to return to the software platform release, and you went through a comprehensive overview that was very helpful. I wonder if you could just maybe touch on the discussions on the strategy. When we think about Snap One, it's a sizable upfront installation and adding a recurring fee on top.

On one hand, it's probably a minor part of the bill of materials based on the pricing that you're suggesting here. On the other hand, a lot of the customers are kind of expecting to pay that one-time large capital-type purchase and not have an ongoing stream.

So I guess the question there would be, when you analyze that, was there other models that you looked at to do this, whether it's maybe like a Tesla or somebody like that? And how did you come with the pricing strategy?And the second piece would be you laid out a very strong case for this to become very material over time. I wonder how you think about perhaps even expanding that ARPU over time with additional features, maybe just take us through the roadmap on how that could become more material from an ARPU and feature standpoint.

John Heyman^ Adam, I want to just congratulate you. I think you squeezed a number of questions into there besides one, so well done. All very good questions, by the way. We -- so, yes, our end customer typically pays a significant price for the acquisition cost of a system. We looked at this in detail, and the prices do range, by the way, and for what we call very light systems, single room, low number of devices.

While there's a subscription for Control4 Connect, that subscription is actually free. Now, that's a small number of our actual installs. But for the price-sensitive customer, there is a free solution. And what we would hope is that they step-up into our more robust solutions over time.

The other element of testing pricing was, for the subscription, we have a product called 4Sight that over 100,000 customers use. We have historically charged the dealer around $130 a year for that product.

The dealers then mark that product up and sell it to the end customer. So when we looked at what the price realization was at the end-market level, we were able to get a good sense of willingness to pay. And that number -- that $250 number felt right.

We looked at having a pricing grid that was more or less than $250. We just decided to keep it simple. Part of the messaging then is, with the homeowner, where you're asking about willingness to pay is that if your provider is not offering you this, that this is a system that runs on software, and that the software helps the system improve over time.

And this is the first time ever that a manufacturer is standing behind the software and committing to improve it. And the market will see notable improvements to the software this year, by the way, that we felt like, why would you ever want to buy a system from someone who isn't charging you this fairly moderate fee to keep your system updated, current in terms of all the number of integrations you have to do, continuing to improve the security of your system, et cetera.

So that was how we addressed kind of the one-time, or Tesla model or the model we ended up on, which was Control4 Connect, which is kind of the annual $250. We did have to build a lot of plumbing into that system because our market is not used to doing recurring revenues. So we did build out the recurring revenue platform for the industry, and that includes billing the customer directly and sharing it with the integrator.

So that's one. Two, I think I addressed the pricing point mostly through 4Sight, but with Assist and with Assist Premium, we also had benchmarks. We know what dealers charge. It's all over the place, by the way, some people think $3,000 a year for a premium service is super-expensive; others think it's incredibly inexpensive.

We've had experience with Parasol, which is roughly anywhere from $500 to $720 a year and we can't -- and Control4 Assist and Assist Premium do more than Parasol. And so after being in market worthwhile again with a number of our members of our Partner

Advisory Board, we felt like the right pricing for the service part of the model was either $900 or $3,000.

And then in terms of the materiality, over time, the numbers start to get very big that I spoke about, and you can see what I mentioned, around $100 million.

If you run those at 55% margins, $55 million on top of our existing operating income today is, number one, quite significant. If we are successful transforming half of our install base, just half of our install base, again, multiply 250,000 more sites times $250 a year, and then add on some services businesses. So it becomes quite significant there.

And then the other component is the ARPU, which, yes, we're thinking about it. We feel like we're building the rails for the industry to deliver services to their end customer. We came out with a new product this past year.

It's won a number of awards. It's getting great reception. It's our Luma x20 surveillance lineup, and it comes with the software product Luma Insights. The market's not used to those types of software services. We've included a 3-year subscription for now in Luma Insights, and that will be -- that's free up front.

But over time, we'll continue expand the video analytics that we have in the system. We think cybersecurity is a big opportunity for the company. The industry's got a lot of talk about it.

And so I think my old company, we started off with one Software-as-a-Service product, we ended up with 20. And today we've got, I think, a few, and we'll continue to evolve that to help provide the right service to the customer and develop healthier models for our integration partners.

Adam Tindle^ That's super helpful. And I mean, it's only right that I follow up with a 2-parter for Mike, but I'll keep it a little bit more brief. Mike, sorry if I missed, but just wondering if you could maybe touch on expectations for cash flow in 2024, the TRA piece of that and what capital structure should look like at the end of the year?

Michael Carlet^ Yes. So on the TRA piece, the payment that is being made in Q1 -- actually was already made was $22 million. For 2025, the expectation right now would be about [$13 million.] That's ought to be subject to change. There's all kinds of things that are out there that could change that, but that's at least what we sit here today.

As far as specific cash flow, we don't guide to cash flows, but I would say that we still believe there's some opportunity on inventory on a run rate basis.

Obviously, as we think about our guidance, if we do see growth, we would expect inventory to grow a little bit. We think our inventory, plus or minus, is at the right level, right now. And so, we should see no significant inventory growth, no significant decreases. If we see some growth in revenue, we probably see a little bit of growth in inventory as we open a few more stores in the back half of the year. That would take a little bit of inventory. Having said, we think it's the right level.

Don't tell my supply chain team that, we keep telling them, they've got opportunity to keep reducing it, so maybe we'll get a little bit more benefit there. But overall, we would expect EBITDA outside our normal CapEx. I think our CapEx in the last couple of years has been a little bit inflated due to the relocation of our [Lehigh] headquarters. I think we spent. I think the CapEx number is about $7 million each year; $7 million in '22 and $7 million in '23. About a third of that, maybe almost a half was actually TI paid.

And so, it wasn't actually cash [with a door], there's some classification. But if you think about real CapEx, if it's been around $21 million, $22 million in the last couple of years, really, the run rate should be about $15 million. Working capital, pretty much neutral, a little bit of growth in line with our revenue growth. And then everything else should be free cash flow, which should be pretty robust and allow us to continue to make good operating decisions as we go forward.

Operator^ (Operator Instructions) At this time, this concludes our Q&A session. I'd now like to turn the call back over to Mr. Heyman for his closing remarks.

John Heyman^ Norma, thank you very much. Again, thanks to all our shareholders out there. I want to say thanks to all of our integration partners who are working so hard week in, week out. Most of all, I want to single out the Snap One team. You guys have been amazing, and the efforts you deliver every day for our end customers, integration partners and our shareholders will pay dividends in the future. Appreciate it, everyone.

Operator^ Thank you for joining us today for Snap One's Fiscal Fourth Quarter and Full Year 2023 Earnings Conference Call. You may now disconnect. Everyone have a wonderful day.